

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF OHIO

IN RE:

M.D. CONSULTANTS, INC.,

Debtor.

M.D. CONSULTANTS, INC.,

Plaintiff,

vs.

MIRACLE EAR, INC., *et al.*,

Defendants.

CASE NUMBER 02-42805

ADVERSARY NUMBER 02-4150

M E M O R A N D U M O P I N I O N

Debtor/Plaintiff M.D.Consultants, Inc. ("MDC") filed for protection pursuant to Chapter 11 of Title 11 of the United States Code (the "Bankruptcy Code") on June 27, 2002 (the "Petition Date"). MDC initiated this adversary proceeding by filing a Com-plaint on September 9, 2002 against Defendants Miracle-Ear, Inc. ("Miracle-Ear") and Giannetto Giannetti ("Giannetti"), an officer of Miracle-Ear. Pursuant to an Order dated January 7, 2003 granting leave to amend its Complaint, on January 16, 2003, MDC filed an Amended Adversary Proceeding to Avoid Fraudulent Transfers, to Recover Money or Property, for Turnover of Property to Obtain an Injunction or Other Equitable

Relief and Other Relief (the "Amended Complaint") against Miracle-Ear, Giannetti and Sears Roebuck and Co.

A trial was held before the Court on May 31 and June 1, 2005 on this matter. MDC seeks compensation as a result of Miracle-Ear's termination of its franchise agreements. MDC alleges that Miracle-Ear collected and wrongfully failed to turnover accounts receivable that belong to MDC and that Miracle-Ear obtained MDC's business through breach of contract, fraud, or fraudulent transfer. As set forth below, MDC prevails in its quest for turnover of the accounts receivable and its claim that Miracle-Ear forgave the indebtedness that MDC owed under the franchise agree-ments.

This Court has jurisdiction over this matter pursuant to 28 U.S.C. § 1334(b). This is a core proceeding pursuant to 28 U.S.C. § 157(b). The following constitutes the Court's findings of fact and conclusions of law pursuant to FED. R. BANKR. P. 7052.

FACTUAL BACKGROUND

Prior to the Petition Date, MDC was the franchisee of Miracle-Ear pursuant to three franchise agreements dated September 28, 2000, as amended (collectively, the "Franchise Agree-ments"), submitted as Joint Exhibits ("Jt. Ex.") 1, 2, and 3. Pursuant to the Franchise Agreements, MDC operated retail estab-lishments that sold hearing aids in several locations throughout northeast Ohio and western Pennsylvania. Several of

these stores were located in Sears stores in space that was subleased from Miracle-Ear. At least two locations - the store in Salem, Ohio and the headquarters in Poland, Ohio - were "stand alone" facilities not related to Sears stores.

Frank Caparso and Michael Caparso (collectively, the "Caparso Brothers") are the principals of MDC. Michael Caparso ("Caparso") was the Vice President of MDC who "ran" the business of MDC. Frank Caparso was the President of MDC, but he did not take an active role in the day-to-day operation of the business.

As of May 2, 2002, MDC owed Miracle-Ear Six Hundred Thirty-Seven Thousand Two Hundred Sixty-One and 21/100 Dollars (\$637,261.21) on an account receivable, of which Five Hundred Eighty-Seven Thousand Eight Hundred Four and 48/200 Dollars (\$587,804.48) was past due. See Jt. Ex. 4. Pursuant to a letter dated May 2, 2002 (the "May 2 Letter"), counsel for Miracle-Ear sent a letter to the Caparso Brothers regarding a "Notice of Default." Jt. Ex. 4. Pursuant to the May 2 Letter, Miracle-Ear gave notice to MDC that MDC was in breach of its obligations under the Franchise Agreements. The May 2 Letter stated that, pursuant to Section 13D of the Franchise Agreements, the franchises would be terminated unless, within thirty (30) days, MDC forwarded a certified check to Miracle-Ear in the amount of Four Hundred Sixty-Nine Thousand Nine Hundred Forty-Two and 34/100 Dollars (\$469,942.34) and structured a payment schedule for the remainder of the balance due. The May 2 Letter warned

that failure to comply with these requirements by June 3, 2002 would result in the Franchise Agreements being "deemed terminated, effective immediately, without further notice." Jt. Ex. 4.

On June 3, 2002, Caparso met with representatives of Miracle-Ear at Miracle-Ear's headquarters in Minneapolis. At the afternoon meeting Caparso informed Giannetti and Bob Wabler that he had not been successful in obtaining refinancing, and, as a consequence, he could not make the required payment to Miracle-Ear. According to Caparso, Giannetti and Wabler left the conference room for approximately five minutes and returned to say that Miracle-Ear would have to take over the franchise. Caparso testified that, upon their return to the room, Wabler stated that Miracle-Ear would buy MDC's furniture and equipment, that MDC would keep its accounts receivable, that MDC could keep its stand-alone stores in Salem and Poland (but it would have to remove the Miracle-Ear name) and that Miracle-Ear would forgive the indebtedness owed by MDC. These discussions were later memorialized by Caparso in a fax sent to Giannetti. Jt. Ex. 5. Miracle-Ear disputes Caparso's version of this discussion, as set forth in its response to the fax. Jt. Exs. 6 and 7. Caparso also testified that Wabler told him that he would not go away "empty handed;" Caparso understood that the value of what Wabler described was approximately One Million Dollars (\$1,000,000.00), which Caparso believed was the approximate value of the MDC

business. Caparso testified that this was less than he wanted, but that he thought it was "reasonable."

Wabler and Giannetti left again for approximately 45 minutes and returned to suggest that Caparso join them at dinner for further discussion. Giannetti and Caparso met with Brian Hugo, Operations Manager of Miracle-Ear, for dinner. See Deposition of Brian L. Hugo (hereafter "Hugo Depo.") at p. 17. At the dinner meeting, specific details of the transition of the franchise from MDC to Miracle-Ear were discussed. According to Giannetti's testimony, the purpose of the dinner meeting was to discuss MDC employees, which Giannetti considered "very important." The three men discussed the individual stores and employees who would be important for a smooth transition. During that meeting, Mitch Angelo was identified as a "top performer" and both Angelo and Dan Romeo were identified as being "at risk" of leaving instead of continuing their employment at their respective stores. See Hugo Depo. at pp. 38-39. Caparso testified that he was asked to try to persuade key employees to stay on after the transition to Miracle-Ear in exchange for forgiveness of MDC's debt. Caparso also testified that it was his understanding that Miracle-Ear would continue to collect on the outstanding MDC accounts receivable and would remit such collected amounts to MDC. In reliance upon these understandings, Caparso contacted key employees and urged them to stay on with Miracle-Ear after termination of the Franchise Agreements.

All parties agree that the discussions at the two meetings in Minnesota were not reduced to a written agreement. Caparso testified that he did not consider this odd because, over the years, several of the agreements between Miracle-Ear and MDC had not been reduced to writing.

Giannetti and Holly Pichner (a Miracle-Ear employee) traveled to the Youngstown, Ohio area the next day, June 4, 2002, and began to meet with employees at the MDC store locations. Giannetti and Pichner made offers of employment to most of the MDC employees, which were eventually accepted.

On or about June 7, 2002, Caparso sent Giannetti a fax dated June 5, 2002 (the "June 5 fax") (Jt. Ex. 5) setting forth his understanding of the June 3 conversations. In response, Giannetti sent a fax to Caparso on June 8, 2002 indicating that the June 5 fax contained "statements [that] are incorrect," and that Miracle-Ear would reply to the June 5 fax "appropriately as soon as possible." Jt. Ex. 6.

Miracle-Ear's attorney sent the Caparso Brothers a letter dated June 11, 2002 (the "June 11 Letter") in response to the June 5 fax. Jt. Ex. 7. The June 11 Letter stated that the fax correctly states that the Franchise Agreements were terminated effective June 3, 2002, but that all other provisions of the June 5 fax were incorrect except that Caparso was partially correct about Miracle-Ear's intention not to exercise its option to assume the stand-alone stores in Salem and Poland.

Within the next few days, Caparso sent Miracle-Ear a list of the open accounts receivable, as well as a list of the furniture and equipment that he anticipated Miracle-Ear was going to purchase.

LEGAL ANALYSIS

The Amended Complaint sets forth five counts, as follows: Count I - Breach of Contract; Count II - Fraudulent Transfer; Count III - Fraud; Count IV - Conversion/Turnover; and Count V - Turnover. The Breach of Contract count alleges that Miracle-Ear agreed to the sale of MDC's franchises in consideration for the application of the debt owed in the amount of Six Hundred Twenty-Seven Thousand One Hundred Twenty-Two and 85/100 Dollars (\$627,122.85), MDC's retention of its accounts receivable in the amount of Two Hundred Twelve Thousand Seventy-Seven and 12/100 Dollars (\$212,077.12) and MDC's retention of its furniture and equipment, valued at One Hundred Twenty Thousand Six Hundred Twenty and 92/100 Dollars (\$120,620.92) (total estimated value of Nine Hundred Fifty-Nine Thousand Eight Hundred Twenty Dollars (\$959,820.00)). Count II alleges that MDC is entitled to avoid the transfer of the franchises, which occurred without adequate consideration while MDC was insolvent. MDC estimates that the value of the franchised locations was not less than One Million One Hundred Thousand Dollars (\$1,100,000.00). In Count III, MDC alleges that Giannetti knowingly, willfully and with the intent to defraud MDC made

representations to cause MDC to transfer MDC'S business to Miracle-Ear. MDC claims damages in excess of One Million One Hundred Thousand Dollars (\$1,100,000.00), as well as punitive damages. Counts IV and V concern Miracle-Ear's collection and retention of MDC's accounts receivable and furniture and equipment, in the amounts of Two Hundred Twelve Thousand Seventy-Seven and 12/100 Dollars (\$212,077.12) and One Hundred Twenty Thousand Six Hundred Twenty and 92/100 Dollars (\$120,620.92), respectively.

Prior to trial, the parties resolved the issue of the furniture and equipment pursuant to an Order (in the Debtor's main case, Case No. 02-42805, rather than this adversary proceeding) dated July 31, 2003, pursuant to which Miracle-Ear purchased such furniture and equipment for Eighty-Five Thousand Dollars (\$85,000.00) and delivered the sale proceeds directly to Sky Bank, which held a first lien on the purchased assets. As a consequence, at the trial, Counts IV and V related only to the accounts receivable.

Also prior to trial, this Court granted partial summary judgment in favor of Defendants on the grounds that, as of June 3, 2002, MDC did not have a pending third-party offer to purchase the franchise or any part of its business.

Count I - Breach of Contract

MDC alleges that, at the June 3 meeting, Miracle-Ear agreed to purchase MDC's business for consideration consisting of

the following elements: MDC would retain its accounts receivable; Miracle-Ear would purchase the furniture and equipment; Miracle-Ear would forgive the debt of MDC; and MDC would keep the stores in Salem and Poland. The total value of this consideration was, according to MDC, approximately One Million Dollars (\$1,000,000.00). MDC acknowledges that this contract was never reduced to writing, but asserts that performing oral agreements was a common practice between the parties.

Miracle-Ear argues that, despite past conduct, which may have included some oral agreements, the Franchise Agreements include a provision that requires any modifications to be in a writing signed by Miracle-Ear in order to be binding.

18. Entire Agreement. This Agreement constitutes the entire understanding between Miracle-Ear and [MDC] concerning the subject matter hereof. . . . No amendment, change, or supplement from or to this Agreement shall be binding on Miracle-Ear unless executed by its authorized officers or agents in writing.

Jt. Ex. 1, p.26, section 18.

Section 16 of the Franchise Agreements, "Approvals and Waivers," provides that: "[n]o failure of Miracle-Ear to . . . insist upon strict compliance by [MDC] with any obligation or condition hereunder, and no custom or practice of the parties at variance with the terms hereof, shall constitute a waiver of Miracle-Ear's right to demand exact compliance with any of the terms herein thereafter." Jt. Ex. 1, p.25, section 16C.

Accordingly, Miracle-Ear contends that, even if there may have been prior oral agreements between the parties, any modification to the Franchise Agreements had to have been in writing.

In general, written contracts may be modified by oral agreements. Here, however, there is an express provision in the Franchise Agreements that prohibits any modification thereto without a writing signed by Miracle-Ear. As a consequence, Miracle-Ear argues that there is an absolute prohibition on any oral agreement. Miracle-Ear's argument, however, is wrong.

The general rule in most jurisdictions is that parties to a written contract may alter or modify its terms by a subsequent oral agreement even though the contract precludes oral modifications:

A written contract may be modified by the parties thereto in any manner they choose, notwithstanding agreements prohibiting its alternation, except in a particular manner. So it is generally held that a contract stipulating that any modification must be in writing may nevertheless be modified verbally.

Park v. Dealers Transit, Inc., 596 F.2d 203, 204 (7th Cir. 1979) (quoting 17A C.J.S. Contracts § 377).

The party seeking to show that an oral agreement modifies a written contract must do so by a preponderance of the evidence. Here, MDC bears the burden to establish that all of the elements of an oral contract, including mutual assent, were present. By virtue of Miracle-Ear's refutation of MDC's

recitation of the alleged oral agreement (see Jt. Exs. 6 and 7), MDC has failed to carry this burden. Clearly, Miracle-Ear denied that any oral agreement existed.

As a consequence, because MDC has failed to establish the requisite elements of an enforceable contract between Miracle-Ear and MDC, the breach of contract claim must fail.

Count II - Fraudulent Transfer

MDC contends that, in June 2002, its business was worth no less than One Million One Hundred Thousand Dollars (\$1,100,000.00). Because Miracle-Ear acquired MDC's business without paying MDC any consideration during a time when MDC was insolvent, MDC alleges that such conduct constitutes a fraudulent transfer.¹ Miracle-Ear argues that MDC mischaracterizes what happened as a "transfer" of the business from MDC to Miracle-Ear when, in actuality, Miracle-Ear exercised its right to terminate the Franchise Agreements. Miracle-Ear points to the May 3 Letter and the Franchise Agreements themselves to support its argument.

At no time has MDC argued that it was not in default under the Franchise Agreements for failure to timely pay the debt it owed to Miracle-Ear. MDC has also not attacked the enforceability of the Franchise Agreements, which governed the

¹On August 25, 2004, the parties filed a Joint Status Report, which stated that the plaintiff would not be pursuing the count for fraudulent transfer. Moreover, because the Court granted partial summary judgment on the basis that there was no pending third-party offer to purchase MDC's business, there is no basis to support MDC's alleged valuation of the business at that time. At trial, however, MDC argued that the testimony supported a cause of action for fraudulent transfer. Accordingly, the Court will address this count as if it has not been waived.

relationship between the parties for several years prior to the June 3 meeting. Pursuant to the terms of the Franchise Agreements, Miracle-Ear had the right to terminate the franchise upon certain events of default. Failure to pay monetary obligations and to cure such default within thirty (30) days was one event of default that permitted Miracle-Ear to terminate the Franchise Agreements and take back the franchise. Jt. Ex. 1, p. 21, section 13D. Miracle-Ear sent MDC the May 3 Letter informing MDC that, if certain steps were not taken to pay down the debt, the Franchise Agreements would terminate, without further notice, at the end of the thirty (30) day period.

With the termination of the Franchise Agreements, Miracle-Ear had the option to take over the leased premises where MDC operated its stores. Here, at all but the Salem and Poland locations, MDC operated stores in space that it subleased from Miracle-Ear in Sears stores. Thus, Miracle-Ear only had to terminate the sublease to re-acquire the premises. At the termination of the Franchise Agreements, MDC had to stop using all Miracle-Ear "Marks" and cease doing business as a Miracle-Ear franchise. Miracle-Ear had the option to purchase furniture and equipment and MDC had to assign its telephone number to Miracle-Ear. Miracle-Ear was also entitled to copies of all files. See generally Section 14 of the Franchise Agreements regarding Obligations Upon Termination, Jt. Ex. 1, at pp. 22-24. As a consequence, once the Franchise Agreements were terminated, MDC

had no "business" to sell. This Court agrees with Miracle-Ear that the conduct at issue was the termination of the Franchise Agreements and not any other transfer of the business that required consideration. Thus, the conduct cannot constitute a fraudulent transfer.

Count III - Fraud

Fraud is a separate and different cause of action from fraudulent transfer. The elements of fraud include: (1) a repre-sentation, (2) which is material to the transaction at hand, (3) made falsely, with knowledge of its falsity, or with such utter disregard and recklessness as to whether it is true or false that knowledge may be inferred, (4) with the intent of misleading another into relying upon it, (5) justifiable reliance upon the representa-tion, and (6) a resulting injury proximately caused by the reliance. See *Glassner v. R.J. Reynolds Tobacco Co.*, 223 F.3d 343, 353 (6th Cir. 2000), incorporating the elements of fraud from *Burr v. Board of County Comm'rs of Stark Co.*, 491 N.E.2d 1101 (1986).

According to Miracle-Ear, termination of the Franchise Agreements was complete at the end of the afternoon meeting on June 3, 2002. Giannetti testified that he told Caparso that afternoon that Miracle-Ear was terminating the franchise and taking over the stores. A reading of the Franchise Agreements and the May 3 Letter support this assertion.

Since termination of the franchise was complete, what

was the purpose of a second meeting at dinner that same day?

Giannetti testified that the purpose of the dinner meeting was to discuss MDC's employees. He said that a smooth transition was necessary to protect the employees and the customers. However, a smooth transition would inure to the benefit of Miracle-Ear, not MDC. Caparso testified that he was asked to contact key employees and try to persuade them to stay on the job when Miracle-Ear took over the stores. Paul D'Amico, Vice President of the parent company of Miracle-Ear, testified that keeping the employees was of "para-mount" importance. Hugo also testified that it was necessary to keep the employees so they "could take care of the . . . customers." Hugo Depo. at p. 39. Even Giannetti acknowledged that keeping key employees was important.

After the dinner meeting, Caparso did, in fact, contact his employees and urge them to stay on. Angelo and Romeo both testified to that effect. Romeo, identified as one of the key employees, testified that Caparso called him the night of June 3 and told him that it was "imperative" that he stay on with Miracle-Ear; he stayed on, in part, because of Caparso's request to do so. Angelo stated that because the employees stayed on, it was business as usual after the transition.

Caparso had no incentive to help Miracle-Ear with a smooth transition of the business if he had not expected something in return. If, as Miracle-Ear contends, the Franchise

Agreements were terminated as of the afternoon of June 3 and Miracle-Ear was to keep the accounts receivable and still hold MDC liable for the entire amount of the unpaid debt, it is doubtful that Caparso would have wanted to socialize with Giannetti and Wabler at dinner that night - let alone expend time and energy to help with a smooth transition.

When asked what MDC had to offer in return for forgiveness of the debt, Caparso testified that he could offer a smooth transition and continuation of employment by the current employees. Although it is true that Miracle-Ear was not constrained in trying to hire the former MDC employees and that it did not need Caparso's permission to recruit such employees, it did need MDC's help in identifying the key employees and top performers. Furthermore, it likely would have been a benefit to Miracle-Ear if Caparso, someone known to those employees, contacted them first and paved the way for Miracle-Ear's employment overtures.

Subsequent to termination of the Franchise Agreements, Caparso had no reason to help Miracle-Ear and yet he could provide unique information and assistance to Miracle-Ear regarding his employees. Caparso's testimony is credible that he was induced by Miracle-Ear to provide the requested information about MDC's employees and contact them to stay on with Miracle-Ear. It appears that Caparso was offered some consideration for his help and cooperation; the only evidence of what that

consideration was comes from Caparso himself. Since Miracle-Ear had no right to retain any of the accounts receivable (see below) and since it was obligated to purchase the furniture and equipment if it desired to keep the same, the only additional consideration for Caparso's cooperation was the promise to forgive MDC's debt to Miracle-Ear. Miracle-Ear contends that it made no promise or representation to Caparso and/or MDC. This Court finds that Caparso's testimony is credible and the testimony of the Miracle-Ear witnesses is not credible regarding the request for Caparso's help in identifying and retaining key employees.

After obtaining the help it required of MDC regarding its key employees, Miracle-Ear disavowed that it ever agreed to forgive MDC's debt. See Jt. Ex. 7. Based upon the evidence, this Court finds, however, that Miracle-Ear made the promise of debt forgive-ness to induce Caparso to help it at a time when Miracle-Ear knew that this representation was false. Caparso reasonably relied on Miracle-Ear's representation. MDC suffered a detriment and Miracle-Ear enjoyed a benefit as a result of this fraudulent representation.

Although there was no direct testimony on the issue of detriment, this Court can infer and find detriment from the facts before it. Because Miracle-Ear clearly waived the covenant not to compete by allowing MDC to retain and operate the Salem and Poland locations, MDC could have tried to retain its key

employees at its own locations. Also, to the extent that MDC's key employees made it more likely that Miracle-Ear would be successful in competing with MDC, MDC suffered a detriment. However, MDC put on no evidence of any monetary damages it incurred as a result of its reliance on Miracle-Ear's representation. As a consequence, this Court is constrained to award any damages to MDC on the fraud count.

Despite MDC's lack of evidence concerning its damages, Miracle-Ear clearly obtained a benefit as a result of its misrepresentation because it was able to employ MDC's top performing employees and have a smooth and seamless transition. As a consequence, this Court finds that Miracle-Ear's promise to forgive MDC's debt in exchange for Caparso's efforts to help Miracle-Ear with a smooth transition, and Caparso's performance, constitute an enforceable oral contract. The elements of contract - an offer and acceptance (in this case, performance) have been established by MDC. Even though MDC did not plead a cause of action for breach of contract regarding the forgiveness of debt in exchange for the smooth transition, the evidence at trial established these elements. This Court will conform the pleadings to the evidence. Miracle-Ear made a promise to forgive the debt owed by MDC in exchange for Caparso's efforts to get MDC's key employees to work for Miracle-Ear. MDC acted in reliance on this promise and performed the acts requested by Miracle-Ear. Miracle-Ear benefitted from its promise, which

induced performance by MDC. Miracle-Ear evidently calculated that the benefit it would receive would be equivalent to the amount of debt that it promised to forgive. As a consequence, this Court holds that, based on an oral contract, Miracle-Ear forgave the indebtedness owed by MDC under the Franchise Agreements.

Counts IV and V - Conversion and Turnover

Nothing in the Franchise Agreements deals with accounts receivable at the termination of such agreements (either on their own terms or upon default). As a consequence, it must be inferred that the accounts receivable, which relate to sales made by MDC prior to termination of the Franchise Agreements, are the property of and belonged to MDC. Thus, these accounts receivable are property of MDC's bankruptcy estate. See Bankruptcy Code § 541. Despite Miracle-Ear's argument that it was entitled to keep collection of the accounts receivable (an argument that was not initially made) as a set off against the debt owed by MDC, the Franchise Agreements fail to recognize any right to setoff accounts receivable. The only setoff right in the Franchise Agreements is in section 14B(9), which provides that, with respect to any repurchase by Miracle-Ear of certain products from MDC, Miracle-Ear had the right to set off such purchases against amounts due from MDC.

As a consequence, Miracle-Ear did not have a contractual right to refuse to turn over the amounts it collected

on account of MDC's prior sales and accounts receivable. The June 11 Letter fails to cite any provision of the Franchise Agreements or any other reason that justifies the allegation that Caparso's understanding regarding the accounts receivables was incorrect.

Miracle-Ear did not change the manner in which it continued to collect accounts receivable and made no attempt to inform the former MDC store locations that collection of MDC accounts receivable should be segregated. See Hugo Depo. at pp. 45-48; Deposition of Gary R. Hudoba at pp. 13-14; and Deposition of Michael P. Wallett at p. 11. In addition, testimony at trial from Angelo established that Miracle-Ear made no attempt to identify any payments made on behalf of MDC accounts receivable. Angelo also testified that Miracle-Ear informed him that Miracle-Ear would pay him the commissions on the sales he made while working for MDC because Miracle-Ear had purchased the MDC accounts receivable. Angelo further testified that, while working for Miracle-Ear after the transition, he saw at least one cancelled check payable to MDC on the Gideon account.

Miracle-Ear did not even attempt to look for any amounts received on MDC's accounts for more than a year after this liti-gation was commenced. D'Amico, one of Miracle-Ear's witnesses, testified that he began to investigate the MDC accounts receivable in mid to late 2003. D'Amico testified that he did not know if he checked the Gideon patient file in

conducting his search for all record of payments. D'Amico stated that he was generally aware that checks were sometimes payable to "Miracle-Ear," and but owed to others, including franchises operating under the "Miracle-Ear" name. He said that Miracle-Ear generally sent such checks back to the franchisee, but his testimony was not specific about the payment made by Gideon (an MDC account receivable).

Counsel for Miracle-Ear stated in pleadings and at trial that Miracle-Ear got off to a "rocky start" with the accounting of collection of the accounts receivable, but thereafter accounted for all collections. Miracle-Ear's conduct, however, regarding the accounts receivable is inconsistent and unbelievable.

On one hand, Miracle-Ear asserts that it believed that it had the right to seize the accounts receivable and set them off against the amount MDC owed to Miracle-Ear.² On the other hand, for a significant period of time, Miracle-Ear insisted that it had collected no amounts on the accounts receivable. It was not until almost a year and a half after the adversary proceeding was initiated that Miracle-Ear conceded that it had collected any amounts. See February 11, 2004 letter from Frederick Coombs to Joseph Lucci and Andrew Suhar (the "Feb. 11 Letter") (Jt. Ex.

²Such setoff was a violation of § 362 of the Bankruptcy Code and Miracle-Ear made no attempt to seek relief from stay from this Court - even after commencement of this adversary proceeding when Miracle-Ear knew that collection of the accounts receivable was at issue.

13), in which counsel for Miracle-Ear states, "[a]fter some very intense and very laborious research, my client has investigated . . . [whether] there was any payment activity on any of those accounts." The Feb. 11 Letter states that the Three Thousand Dollar (\$3,000.00) payment by Frank Hanzely (the "Hanzely Payment") was not on account of MDC, but was a payment on his regular Sears account and the fact that the amount coincides with the amount due to MDC is "nothing more than a coincidence." In the end, Miracle-Ear concedes that it had collected Thirty-Seven Thousand Five Hundred Eighty-Two and 85/100 Dollars (\$37,582.85) (after subtracting for Miracle-Ear refunds) on MDC's accounts receivable. The Feb. 11 Letter insists that this amount constitutes the totality of the amount that could be claimed for turnover and thus the adversary proceeding should be dismissed.

By letter dated May 6, 2004 (the "May 6 Letter"), however, counsel for Miracle-Ear concedes that the Hanzely Payment "is, in fact, subject to the turn over." See Jt. Ex. 14. Then in a July 30, 2004 letter (the "July 30 Letter") (Jt. Ex. 15), counsel for Miracle-Ear states that after an "exhaustive review of the store files and the materials produced in response to subpoena" Miracle-Ear found another One Thousand Seven Hundred Seven Dollars (\$1,707.00) that it had collected on the MDC accounts receivable. At the end of the trial, counsel for Miracle-Ear stated that even though Miracle-Ear had turned over all of the monies collected on MDC's accounts receivable, it

would look into whether it had received payment on the Gideon account and, if so, would turn it over. This concluding statement is inconsistent with an assurance that collection of all MDC accounts receivable have been accounted for.

Under the circumstances, Miracle-Ear is the only party that can know if it collected any amounts on the MDC accounts receivable. Miracle-Ear was less than forthcoming with respect to the MDC accounts receivable from the start. Miracle-Ear knew that it had no legal right to setoff the collection of monies on the MDC accounts receivable under the Franchise Agreements and pursuant to § 362 of the Bankruptcy Code.

As early as November 18, 2002, MDC's counsel requested that Miracle-Ear identify the accounts that Miracle-Ear had collected so that MDC could proceed with any collection actions on other accounts. Miracle-Ear's failure to produce this information prohibited MDC from taking any effective action to collect on the open accounts.

The parties entered into an Agreed Stipulation of Fact as to Customer Witnesses ("Stipulation") (Docket # 221) that sets forth their agreement concerning certain categories of accounts receivable. Based upon Miracle-Ear's failure to take any action to segregate or otherwise account for collection on MDC's accounts receivable and its cavalier attempts to investigate such collection, this Court finds it reasonable to impute to Miracle-Ear receipt of all amounts set forth in the Stipulation. This

Court holds that Miracle-Ear owes MDC Eighty-Nine Thousand Six Hundred Seventy-Six and 28/100 Dollars (\$89,676.28), which represents the sum of categories on the Stipulation, less the amount of Forty Thou-sand Five Hundred Eighty-Two and 85/100 Dollars (\$40,582.85) that Miracle-Ear tendered and paid to Sky Bank pursuant to Stipulation approved by this Court on May 28, 2004, for a total owing of Forty-Nine Thousand Ninety-Three and 43/100 Dollars (\$49,093.43).

An appropriate Order will follow.

HONORABLE KAY WOODS
UNITED STATES BANKRUPTCY JUDGE

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF OHIO

IN RE: *
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M.D. CONSULTANTS, INC., *
* CASE NUMBER 02-42805
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Debtor. *
*

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M.D. CONSULTANTS, INC., *
*
Plaintiff, *
*
vs. * ADVERSARY NUMBER 02-4150
*
MIRACLE EAR, INC., *et al.*, *
*
Defendants. *
*

O R D E R

For the reasons set forth in this Court's Memorandum Opinion entered this date, Count I of the Amended Complaint - Breach of Contract, is denied; Count II of the Amended Complaint - Fraudulent Transfer, is also denied; Count III of the Amended Complaint - Fraud, is conformed to breach of oral contract and is granted; Counts IV and V of the Amended Complaint - Conversion/ Turnover and Turnover, respectively, are also granted. Sky Bank has a first lien on the amounts recoverable pursuant to Counts IV and V up to the amount of its secured claim.

IT IS SO ORDERED.

**HONORABLE KAY WOODS
UNITED STATES BANKRUPTCY JUDGE
CERTIFICATE OF SERVICE**

I hereby certify that a copy of the foregoing
Memorandum Opinion and Order were placed in the United States
Mail this _____ day of August, 2005, addressed to:

ANDREW W. SUHAR, ESQ., 1101 Metropolitan
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Metzenbaum U.S. Courthouse, 201 Superior
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JOANNA M. ARMSTRONG